TENGKU DATO' IBRAHIM PETRA TENGKU INDRA PETRA & ORS

v.

PERDANA PETROLEUM BHD

HIGH COURT MALAYA, KUALA LUMPUR
MOHAMAD ARIFF MD YUSOF J
[ORIGINATING SUMMONS NO: D-24NCC-73-02/2012]
6 SEPTEMBER 2012

COMPANY LAW: *Articles of Association - Contractual effect - Legal status of Articles of Association - Incorporation into contract between director and company - Dismissal as directors - Companies Act 1965, s. 140*

COMPANY LAW: *Directors - Indemnity - Extent of companies' liability to indemnify directors - Whether company liable to indemnify directors from liability incurred in a successful legal suit*

The plaintiffs were the former directors of the defendant company, Petra Perdana Berhad ('PPD') who were removed as directors by a resolution of an Emergency General Meeting ('EGM'). The plaintiffs relied on an indemnity provision in art. 170 of the company's Articles of Association and prayed for a declaration that they were entitled to be indemnified by the company for the legal fees incurred by them in defending a derivative action instituted by a minority shareholder of the company in which the plaintiffs had secured a judgment in their favour from the High Court. The plaintiffs further sought a court order to compel the company to pay a sum of RM304,500 and interest thereon at 4% from the date of judgment until full satisfaction being the legal fees incurred by them in defending the action. The derivative action was dismissed on the ground that since the plaintiffs were removed as the directors of the company, the substratum to continue with the derivative action had collapsed. The company subsequently filed an action against the plaintiffs and three other parties on a claim which mirrored the earlier derivative action. The issues that arose for the court's determination were: (i) the extent of which the company would be held liable to indemnify its directors who were sued for negligence, default, breach of statutory duty or fiduciary duty where the directors had defended and obtained a judgment in their favour; and (ii) the legal status of a company's Articles of Association in order to justify its incorporation as part of the terms of the contract between a director and a company.

Held (dismissing plaintiffs' claim with costs):

(1) Section 140 of the Companies Act 1965 provides that clauses which indemnify any officer or auditor of the company from liability in respect of any negligence, breach of duty, default or breach of trust shall be void. By way of exception, the officer could be indemnified against any liability incurred when the judgment is given in his favour or in which he is acquitted. (para 7)

(2) As the terms concerned the director, he or she should be allowed in law to take the obligations imposed as well as the benefits conferred by necessary inference of the articles. Since the appointment was done based on the 'footing of the articles' it would take very little to incorporate art. 170 of the company's Articles of Association into the contract between the plaintiffs and the company as the plaintiffs were subsequently dismissed on the same footing at the EGM of the company. (para 28)

(3) The derivative action was dismissed purely on the ground of failure of substratum since the plaintiffs, being dismissed at the EGM, were no longer in control of the company to attract the exception to the rule in *Foss v. Harbottle*, and to support the derivative action. (para 34)

(4) There was no judgment in relation to the issue of liability of the plaintiffs for the alleged breaches of duty as directors. The plaintiffs have not been held innocent of the allegations nor vindicated. The company itself is pressing ahead with its own claim against them based essentially on the same allegations. It will be grossly wrong in these circumstances to allow the company's assets to be used to pay the legal costs incurred by the plaintiffs. (para 34)

Case(s) referred to:

Branch v. Bagley [2004] EWHC 426 ***(refd)***

Chee Kheong Mah Chaly v. Liquidators of Baring Futures (Singapore) Pte Ltd [2003] 2 SLR (R) 571 ***(refd)***

Fay v. Moramba Services Pty Ltd [2010] NSWSC 725 ***(refd)***

Foss v. Harbottle [1843] 67 ER 189 ***(refd)***

Global Link Telecommunications v. Wilmbury [2002] EWHC 1988 ***(refd)***

In re Anglo-Australian Printing and Publishing Union (Isaac's Case) [1892] 2 Ch 158 ***(refd)***

John v. Price Waterhouse [2002] 1 WLR 953 ***(refd)***

Porter v. GIO Australia Ltd & Anor [2003] NSWSC 668 ***(refd)***
Young v. The Naval, Military, and Civil Service Co-operative Society of South Africa, Limited [1905] 1 KB 687 ***(refd)***

Legislation referred to:
Companies Act 1965, s. 140(2)
Interpretation Acts 1948 and 1967, s. 17A
Rules of the High Court 1980, O. 14A

For the plaintiffs - James Khong; M/s James Khong
For the defendant - Robert CC Low (Derrick Chan & Janice Yap Yen Lin with him); M/s Ranjit Ooi & Robert Low

Reported by Sandra Gabriel

JUDGMENT

Mohamad Ariff Md Yusof J:

[1] The plaintiffs in this originating summons are former directors of the defendant company. The first plaintiff, until his removal from the Board of Directors of the company, was also the Chief Executive Officer and Executive Chairman of the company, which was formerly known as Petra Perdana Berhad. The plaintiffs were removed as directors of the company by a resolution of an emergency General Meeting of the company convened on 4 February 2010.

[2] By this action, the plaintiffs of relying on an indemnity provision in article 170 of the company's Articles of Association, which reads:

> Every director, managing director, agent, auditor, secretary, and other officer for the time being the company shall be indemnified out of the assets of the company against any liability incurred by him in defending any proceedings, whether civil or criminal, in which judgment is given in his favour or in which he is acquitted or in connection with any application under the Act in which relief is granted to him by the court in respect of any negligence, default breach of duty or breach of trust.

[3] The plaintiffs pray for a declaration that they are entitled to be indemnified by the company for their liability incurred in defending an action instituted by a minority shareholder of the company against them for breach of duty of care, statutory and fiduciary duties to Petra Perdana Berhad being its directors, in which the plaintiffs had successfully secured a judgment in their

favour on 16 August 2010 from the High Court. Further, the plaintiffs seek an order of this court to compel the company to pay them the sum of RM304,500, being the legal fees (ie, the liability) incurred by them in successfully defending the action by the minority shareholder, and interest thereon at 4% per annum from the date of judgment until full satisfaction.

[4] Putting it very simply, these former directors claim to be indemnified by the company for legal fees incurred by them in defending the suit instituted against them by a minority shareholder for breach of duty of care, statutory and fiduciary duties in their capacity as directors of the company. They say they have successfully defended the action and have a judgment in their favour granted by the High Court. They are therefore entitled to be indemnified by the very terms of article 170 of the company's Articles of Association.

The Issue

[5] This then is the very short issue raised in this originating summons: to what extent can a company be held liable to indemnify its directors or officers who are sued for negligence, default, breach of statutory duty or fiduciary duty, where the directors have defended the action against them successfully and obtained a judgment in their favour?

Section 140 Companies Act

[6] Aside from provisions in the Articles of Association bearing on this matter, the issue also involves a consideration of s. 140 of the Companies Act 1965:

> 140(1) Any provision, whether contained in the articles or in any contract with the company or otherwise, for exempting any officer or auditor of the company from, or indemnifying him against, any liability which by law would otherwise attached to him in respect of any negligence, default, breach of duty or breach of trust, of which he may be guilty in relation to the company, shall be void.
>
> (2) Notwithstanding anything in this section the company may pursuant to its articles or otherwise indemnify any officer or auditor against any liability incurred by him in defending any proceedings, whether civil or criminal, in which judgment was given in his favour or in which he is acquitted or in connection with any application in relation thereto in which relief is under this Act granted to him by the court.

[7] This therefore is the statutory setting; any provision in the articles or in any contract with the company, or "otherwise", which purports to indemnify any officer or auditor of the company from any liability in respect of any negligence, breach of duty, default or breach of trust, shall be void. By way of exception, however, the company may by its articles or "otherwise" indemnify such officer or auditor against "any liability incurred by him" in which judgment is given in his favour or in which he is acquitted. The legislative drafters in their wisdom have crafted this balance very carefully. As will be seen when the law is applied to the facts of this present dispute, this statutory formula becomes highly significant. I will return to this point subsequently, once the background facts are fully analysed.

Further Background Facts

[8] To return to background facts relating to the suit instituted by the minority shareholder against the plaintiffs ie, Kuala Lumpur High Court Civil Suit No. D-22NCC-735-2009, the minority shareholder in fact instituted the case as a derivative action in which the company was named as a nominal defendant. The minority shareholder is one Encik Shamsul bin Saad, who was, and is, a director of the company as well. To be exact, the suit was filed on 21 December 2009 and it alleged the abovestated breach of duty of care, statutory and fiduciary duties by the plaintiffs (the defendants in that suit) to the company. The full claim included the following:

(a) An order declaring that the defendants (the present plaintiffs), being the directors of Petra Perdana Berhad, had breached their duty of care, and their statutory and fiduciary duties to Petra Perdana Berhad;

(b) An order declaring that by the disposal of 10,500,000 shares in Petra Energy Berhad by *inter alia* the defendants on 11 September 2009, the defendants had breached the general mandate of Petra Perdana Berhad's shareholders dated 26 April 2007 which was renewed on 25 June 2009;

(c) An order declaring that the disposal of 48,800,000 shares in Petra Energy Berhad *inter alia* by the defendants on 11 December 2009 had breached the decision of Petra Perdana Berhad's Board of Directors; and

(d) The defendants are to pay damages suffered by Petra Perdana Berhad.

[9] See exh. A1 in the supporting affidavit by Datin Che Nariza Hajjar Hashim for a copy of the writ of summons and statement of claim filed in this derivative action.

[10] As at the date of the filing of the suit, the Board of Directors of Petra Perdana Berhad comprised of the four plaintiffs, Encik Ahmad bin Haji Mohd Sharkan and Encik Shamsul bin Saad. On the facts therefore the Board of Directors was then in the control of the plaintiffs.

[11] On 6 January 2010 there was a requisition by the shareholders of the company, constituting 1/10th of the issued and paid-up share capital of the company, for the convening of an Extraordinary General Meeting of the company on 4 February 2010. The agenda for the EGM included the removal of the plaintiffs as directors of the company and the appointment of other persons as directors in their place. The EGM was held on 4 February 2010 and the plaintiffs were removed as directors of the company. Following that three new directors were appointed, namely Encik Surya Hidayat bin Abdul Malik, Ganesan a/l Sundaraj and Dato' Kho Poh Eng to constitute the board together with the earlier mentioned Encik Ahmad bin Haji Mohd Sharkan and Encik Shamsul bin Saad.

[12] The evidence indicates that there were two applications on or about 18 February 2010 by the plaintiffs to strike out the civil suit on the basis that it did not disclose any reasonable cause of action, but these applications were dismissed.

[13] About six months later, namely on 10 August 2010, the plaintiffs filed a further application, this time under O. 14A of the Rules of the High Court 1980 which basically challenged Encik Shamsul's standing to maintain the civil suit. The question of law for determination by the Honourable Court stated as follows:

> (a) Whether the Plaintiffs' derivative action under the "fraud on the minority" exception to the *Foss v. Harbottle* rule is suitable in law when facts and events subsequent to the filing of the action have negated any alleged control of the fifth Defendant ("the company") on the part of the alleged wrongdoers, namely the first to fourth Defendants.

And upon the determination of the above question, for the following orders:

(a) the Plaintiffs' action be dismissed with costs;

(b) the costs of this application be borne by the Plaintiff; and

(c) any other order of relief as this Honourable Court deems fit

...

[14] This application was premised on the ground that with the plaintiffs' removal as directors of the company at the EGM, they were no longer in control of the company and therefore there was no further basis for Encik Shamsul to continue with the derivative action. The O. 14A application was heard before Justice Datuk Dr. Haji Hamid Sultan bin Abu Backer who agreed with the present plaintiffs' (then defendants') submissions and determined that it was no longer possible to continue with the derivative action. The learned judge held that the substratum to continue with the derivative action had collapsed. The plaintiff's (Encik Shamsul's) action was therefore dismissed with costs of RM10,000. See exh. A2 to the supporting affidavit for a copy of the detailed written judgment of Justice Datuk Dr. Haji Hamid Sultan bin Abu Backer. This judgment is the foundation for the present claim by the plaintiffs to be indemnified under article 170 of the company's Articles of Association.

[15] The facts also disclosed that although the derivative action was dismissed on the ground of a failure of substratum, the company subsequently filed an action against the present plaintiffs and three other parties (TA Securities Holdings Berhad, Yap Hock Heng and TA First Credit Sdn Bhd) on a claim which mirrors the earlier derivative action. See exh. D11 to the defendant's first affidavit affirmed by Dato' Kho Poh Eng. The company is now directly alleging the very same breach of duty, breach of statutory duty and breach of fiduciary duty on the part of the plaintiffs in relation to the sale and disposal of the Petra Energy Sdn Bhd shares. This suit is before another NCC Court and is pending disposal by a full trial.

The Law

[16] The background factual scenario having been outlined, it is now necessary to explore the law to determine whether the plaintiffs' claim is justified.

[17] Plaintiffs' counsel, Mr. James Khong, argues there exists a judgment in the plaintiffs' favour with respect to proceedings instituted against them for breach of duty, breach of statutory duty and fiduciary duty, and since they have incurred a liability in the form of legal costs in defending the proceedings, the indemnity provision in article 170 of the Company's Articles of Association applies. The plaintiffs, according to this argument, have a right to be indemnified from the assets of the company against the legal costs incurred since they were all directors at the material time. Counsel also refers to s. 140(2) of the Companies Act 1965 and its reference to "the company may pursuant to its articles or otherwise indemnify any officer or auditor against any liability incurred by him in defending any proceedings, whether civil or criminal, in which judgment was given in his favour", highlighting to the court that article 113 of Table A was adopted by the company. Article 170 is exactly the same as article 113 of Table A.

[18] The strong position is taken that "relatively little may be required to incorporate the articles by implication" into the contract between the company and its directors (*Global Link Telecommunications v. Wilmbury* [2002] EWHC 1988 (QB)). It is argued the threshold for incorporation should be very low. Cases along the same lines cited by counsel include *John v. Price Waterhouse* [2002] 1 WLR 953, *In re Anglo-Australian Printing and Publishing Union* (*Isaac*'s *Case*) [1892] 2 Ch 158, and the more recent Singapore Court of Appeal decision in *Chee Kheong Mah Chaly v. Liquidators of Baring Futures (Singapore) Pte Ltd* [2003] 2 SLR (R) 571.

Legal Nature Of Articles Of Association And Effect On Director's Contract With Company

[19] The fundamental legal problem the plaintiffs have to confront is the issue of the legal nature of the Articles of Association of a company. While it is reasonably clear that the articles constitute a contract between members of a company and between the members and the company (see s. 33(1) of the Companies Act 1965), it is legally less certain how the articles stand in relation to the contractual relationship between directors and other officers of the company (including its auditors). The differing approaches presented by counsel for the plaintiffs and the defendant manifest this ambiguity. Both rely on the principles presented in *Global Link Telecommunications v. Wilmbury*, *supra*, where Stanley Burton J stated *inter alia*:

> The articles of association of a company are as a result of statute a contract between the members of the company and the company in relation to their membership. The Articles are not automatically binding as between a company and its officers as such. In so far as the articles are applicable to the relationship between a company and its officers, the articles may be expressly or impliedly in the contract between the company and a director. *They will be so incorporated if the director accepts appointment "on the footing of the articles", and relatively little may be required to incorporate the articles by implication*" (at page 154 of the report and citing *John v. Price Waterhouse*). (emphasis added)

[20] What is implied by the phrase "on the footing of the articles" can be a matter of some debate. This phrase also appears, with a difference in emphasis, in *Isaac*'s *Case*:

> I think, then, that where a man has accepted the office of director, and acted as such, there ought to be inferred an agreement between him and the company, on his part that he will serve the company on the terms as to qualification and otherwise contained in the articles of association, and on the part of the company that he shall receive the remuneration, and all the benefits which those articles provide for directors. To use the language of the present Master of the Rolls in *Swabey v. Port Darwin Gold Mining Company* …, "the articles do not themselves form a contract, but from them you get the terms upon which the directors are serving (at pages 164-165 of the report).

[21] On the basis of these cases, counsel for the plaintiffs has taken a straightforward approach: where there is no written contract, article 170 applies by incorporation.

[22] There is an immediate conceptual difficulty with this approach since on the facts the first plaintiff at least has a written employment contract with the company, but nowhere in the terms is there any reference to the Articles of Association.

[23] Mr. Robert Low, for the defendant, adopts a different approach. Even though very little is required to incorporate the articles into the contract between a director and the company, it is submitted, "something must be done" (to repeat the words of counsel). I understand this approach to imply there has to be some document (a contract, a letter of appointment, or even a resolution of the company to appoint the director) where some reference to the articles can be found. Then and then alone can there be said to be an appointment "on the footing of the articles".

[24] Mr. Robert Low uses as a convenient starting point for his submission, the old English case of *Young v. The Naval, Military, and Civil Service Co-operative Society of South Africa, Limited* [1905] 1 KB 687, and the following passage in the judgment of Farwell J:

> But in my opinion, the law on the subject is plain. *"Directors have no right to be paid for their services, and cannot pay themselves or each other or make presents to themselves out of the company's assets, unless authorised so to do by the instrument which regulates the company or by the shareholders at a properly convened meeting"*: *In re George Newman & Co* ..." (at page 693 of the report).

[25] The general legal notion that "directors have no right to be paid for their services", if not qualified in a more rational sense so as to better accord with current corporate reality, will certainly send alarm signals to many boardrooms in Kuala Lumpur and our other commercial centres. It will come as a surprise to many commercial men that as directors they are expected in law not to have any right to be paid for their services but to perform a duty more or less on a charitable basis, unless expressly authorised by the articles or by shareholders' resolution. What it implies is that unless the facts allow some incorporation of the articles into the contractual relation between a director and a company, the director will be completely at the mercy of the shareholders. This will have special significance in the context of the right to be indemnified from the assets of the company as provided in a provision such as article 113 of Table A. This cannot be right commercial sense or correct law.

[26] In fairness to this old decision, there are better passages in the judgment which explains the relationship between a director and a company in a commercially rational way. I refer here to the continuing passage reading:

> But directors being both agents of and trustees for the company are entitled to be indemnified by the company against all losses and expenses properly sustained and incurred by them in the due performance of their office. They are both trustees and agents-trustees of the company's property, with their liabilities of trustees in respect thereof ... and agents in the transactions which they enter on behalf of the company. Their right to indemnity arises by the implication of a contract from the relation between themselves and the company, and therefore depends on the particular relation existing, for different contracts are implied from different relations. Thus an unpaid trustee is entitled to complete indemnity for all proper expenses incurred by him in the execution of his trust ... (at pages 693 - 694).

[27] The analysis of the office of a director being one of trust or agency depending on the facts, and for which the director will have a right to be indemnified from the assets of the company for expenses incurred on behalf of the company is a better explanation of the legal position of a director in a company. Nevertheless, the cases do indicate the relationship between a director and the company is basically a contractual relationship, a conclusion which is all too clear where the director is an Executive Director who becomes part of the "management" of the company aside from being a Board Member. The first and second plaintiffs, for example, were Executive Directors. As earlier mentioned, the first plaintiff held the office of CEO as well as Executive Chairman of the company, and there was an employment contract signed between him and the company. The issue is to what extent the terms of the Articles of Association can be imported or incorporated into this contractual relationship? The cases suggest the incorporation depends on whether the director's appointment is done "on the footing of the articles". In this connection again, a healthy dose of commercial reality will assist in understanding and formulating a rational basis for the law. I am tempted to ask: in these days of sophisticated corporate affairs and detailed company law provisions, how else can directors be appointed to the Board except on "the footing of the articles"? It is an obvious necessary pre-condition for a valid Board appointment. In this sense, the view that "it takes very little" to incorporate the articles into the director's contract can be more readily and realistically understood. I am therefore of the view that principles so ably stated in *Isaac*'s Case should be preferred, and bear repetition for emphasis:

> I think, then, that where a man has accepted the office of director, and acted as such, there ought to be inferred an agreement between him and the company, on his part that he will serve the company on the terms as to qualification and otherwise contained in the Articles of Association, and on the part of the company that he shall receive the remuneration, and all the benefits which those articles provide for directors.

Findings And Conclusions On The Law

[28] There is really no pressing need to exhaust further legal scholarship to search for the exact legal status of a company's Articles of Association in order to justify its incorporation as part of the terms of the contract between a director and a company,

insofar as the terms concern the director. He or she should be allowed in law to take the obligations imposed, as well as the benefits conferred, by the articles by necessary inference.

[29] On this point, I am therefore of the view that it "takes very little" to incorporate article 170 into the contract between the plaintiffs and the company since obviously these persons must have been appointed on "the footing of the articles", just as they were subsequently dismissed on the same footing at the EGM of the company.

[30] Having so decided, the next issue is one of whether the plaintiffs have satisfied the requirements under article 170.

[31] This issue is one of construction, not only of article 170 but also of s. 140 of the Companies Act 1965, which provides the statutory rationale. Mr. Robert Low has very correctly drawn a distinction between the two sub-sections of article 140; sub-s. (1) invalidates any indemnity provision, but sub-s. (2) carves out a special exception in permissive terms. Article 170 therefore cannot be read as conferring a broad right to indemnity irrespective of the precise facts. The key lies in the words "judgment is given in his favour or in which he is acquitted …". Counsel has strongly argued that these words must signify a "judgment" which contains an element of "vindication" or "innocence" decided by the court upon hearing of the merits. Looking at how s. 140 is worded, and reading both sub-sections purposively in accordance with the settled approach to statutory interpretation as laid down in s. 17A of our Interpretation Acts 1948 and 1967, I agree with Mr. Robert Low's submission, since article 170 has to be given a meaning consonant with s. 140.

[32] Counsel's reliance on *A. Ramaiya's Guide to the Companies Act* (14th edn., 1998) is pertinent:

> **Indemnity against expenses of defence [Proviso to sub-section (1)]** [of Section 201 of the Indian Companies Act, which is largely in *pari materia* with our Section 140]
>
> The object of the proviso is to enable a company to indemnify against liability incurred in defence any of its officers in the event only of his having been found by a competent court to be innocent or to have acted *bona fide* ie, honestly and not in any other case.

[33] I have also taken into consideration the case law represented by *Branch v. Bagley* [2004] EWHC 426, *Fay v. Moramba Services Pty Ltd* [2010] NSWSC 725 and *Porter v. GIO Australia Ltd & Anor* [2003] NSWSC 668. In *Fay v. Moramba Services Pty Ltd*, for instance, it was held:

> Here the relevant claim did not go to judgment, but was abandoned and ultimately formally withdrawn by amendment to the pleading; that is in substance, a discontinuance. On the claim made against them qua directors, there was no judgment in favour of the Defendants. The indemnity under Article 113 is therefore not enlivened. (at paragraph 15 of the judgment)

[34] On the facts of this present case, as earlier stated, the derivative action was dismissed purely on the ground of failure of substratum since the plaintiffs here, being dismissed at the EGM, were no longer in control of the company to attract the exception to the rule in *Foss v. Harbottle* [1843] 67 ER 189 and to support the derivative action. There was no judgment in relation to the issue of liability of the plaintiffs for the alleged breaches of duty as directors. The plaintiffs have not been held innocent of the allegations nor vindicated. The company itself is now pressing ahead with its own claim against them based essentially on the same allegations. It will be grossly wrong in these circumstances to allow the company's assets to be used to pay the legal costs incurred by the plaintiffs.

[35] Given my findings on these facts, it is not necessary for me to express a view on whether the plaintiffs have substantiated the exact quantum of their claim. This will be a question of proof on the evidence, which in an ordinary case can be answered by the court making necessary ancillary orders. It is however not necessary to do so in this case.

Decision And Order

[36] Based on these findings and a consideration of the law as submitted by all parties, I am dismissing the plaintiffs' claim with costs of RM15,000 to be paid by the plaintiffs to the defendant.

[37] I wish to also place on record my appreciation to both counsel for their diligence in researching the law and for their able submissions.